

EDINBURGH TRAM NETWORK MAYDAY OPTIONS

COMMERCIALLY CONFIDENTIAL

Background as at 11.00am Thursday 1st May 2008

On 30th April 2008, in a telephone call to Willie Gallagher, BB (Richard Walker) requested a last minute, substantial and unsupported price increase. This was at the final point before the pre-agreed timing of contract approval for signature. No such request has emerged from Siemens or from CAF or indeed SDS. The anticipation was that the contracts would be signed on 2nd May and a period of 36 hours was needed for completion preparation.

An emergency meeting of those members of the Tram Project Board who were available plus other parties was held on 30th April. Attending were :

Tie - Willie Gallagher, Steven Bell, Stewart McGarrity and Graeme Bissett
CEC – Donald McGougan, Dave Anderson, Marshall Poulton
TEL – David Mackay
DLA – Andrew Fitchie (latter part of meeting)

The options available were discussed and it was concluded that we should deploy tough tactics, but not stonewall the BB request completely as it was felt that the alternatives were likely to be worse notwithstanding the intense frustration at BB's tactics.

The agreed next steps were :

1. Tie would inform BB and S that tie will not accept last minute price gouging
2. A proposal from senior BB management that they would visit Edinburgh on Monday 5th May would be encouraged
3. We will cease legal engagement with the consortium, but work to freeze documents in a controlled manner
4. Means would be derived to communicate to Siemens that they had a responsibility to get BB into line and also to apply leverage against Siemen's reputation within the Scottish and UK public sector
5. CAF, SDS and TS would be informed
6. Council officials will consider how to disclose the matter properly to Councillors around the Council meeting on 1.05.08, bearing in mind the commercial sensitivity at this delicate point.

Actions 1-5 have been executed. BB management will visit Edinburgh on 5th May.

The purpose of this note is to analyse the alternative options to an agreement with BBS.

Gold Option

- BB withdraw the price gouge attempt, their lawyers engage properly to conclude contract details and the suite is signed later in w/b 5th May.

Issues :

- Tie willingness to entrust BB with the contract – we are ready to deal with them post-Close

Silver Option

- BB will not withdraw the price gouge but a negotiated number is agreed. Proceed as under Gold.

Issues :

- Justification for any compromise sum – almost certainly less expensive than other options except Gold. Tie will seek to generate value for any sum conceded by means of buying out risk, providing incentivisation, removing uncertain elements of the contract
- Relationship of final sum to the Council Report to be approved today – the sum agreed will dictate what additional approval is required
- Need to control any ambitions among Siemens and CAF for any similar last-minute hikes – tactics to be defined
- Tie willingness to entrust BB with the contract – we are ready to deal with them post-Close

Bronze option

As Silver, but BB go away for a period – say a week – before coming back to the table

Issues :

- As Silver, plus
- Communication of position externally – need a pre-pack announcement ready
- Assess cost of a short-term delay (say 2 weeks) compared to final proposed ransom payment to BB agreed on 5th May – will be evaluated before 5th May, unlikely to be significant

Iron options

- BB continue to demand substantial price gouge, tie will not relent and the position is supported by CEC and TS.
- Tie terminates procurement process with BBS consortium

Options

- A. Siemens offered option to restructure consortium, incorporate a new civils contractor and confirm previous contract terms
- B. Tramlines re-introduced
- C. Full-scale re-procurement including PIN
- D. Project termination

Basis for termination

Tie is entitled to terminate the BBS consortium's preferred bidder status because BBS have materially changed the price. Termination on this basis carries no risk of effective litigation by BB / S against tie. There is an additional responsibility on tie to respect Tramlines' interest in the transaction and a risk of challenge by Tramlines if tie does not.

The grounds on which BB seek to justify the price increase are important. In the conversation between Walker and WG, the grounds were stated as SDS risk, euro / sterling devaluation and supplier price pressure. There was also reference to BB making mistakes which had only recently been identified. These are not valid grounds for a price change at this stage and open BBS to litigation by tie.

- At this point, it is critical that the conversation between Walker and WG is properly documented as this will be key evidence in any litigation.
- It is also important that a record of the meeting with the senior BB and S management on 24th April is created because that was the basis on which we believed the deal was done except for legal due diligence.

BB may change their purported rationale on Monday 5th and we can deal with that if it happens.

(A) Siemens led consortium

It would be legally competent for tie to engage with the preferred bidder consortium with a new civils contractor replacing BB. The drivers behind this would be Siemens desire to stay in the race and tie's desire to conclude as quickly as possible.

The process would involve :

- Siemens exiting BB from the consortium
- Identification and presentation by Siemens of a new consortium
- Re-qualification by tie of the new consortium
- Re-engagement on the contract suite

The implications are not straight-forward :

- The timescale is likely to be around 3 months if matters progressed reasonably well. Programme will move out by this extent.
- There will be important changes to the current Infraco contract terms to accommodate 1) passage of time (eg programme, design & consents, MUDFA interface) ; 2) requirements of new contractor (unknown).
- Likely that tie would be required by a new contractor to meet bid costs
- No guarantee that the revised consortium would adhere to previous deal and a strong likelihood that both consortium members would seek increments for inflation and other factors ; impossible to estimate at this stage whether there would be adequate compensating factors (such as reduced SDS risk)
- Limited likelihood of imposing effective sanctions on Siemens to adhere to existing terms – eg pay bid costs only if they stay within current contract terms especially price
- Probable need to re-assess SDS Novation Agreement (driven by SDS)
- Presumption that CAF will happily go along with this and not seek incremental costs

Although unpalatable, this is the best alternative to completion with BBS and we could reasonably expect both CEC and TS to be supportive given the level of investment already made.

(B) Reinroduce Tramlines

Retention of under-bidder interest in a deal is designed to accommodate the scenario we may now be in. Tramlines were an entirely credible partner and the preferred bidder decision was close. There were no knock-out defects in the Tramlines bid.

The process can be shaped by tie and would best involve :

- Tie terminating BBS
- Tie revising the original Tramlines contract to accommodate tie's preferred (and reasonable) position as reflected in the current Infraco contract, but with all undesirable concessions removed (decision needed on how to put price into play)
- Agree a one-month "hot review" by Tramlines to confirm all material contract terms or flag variations ; if we are in the same ballpark -
- Finalise all material terms
- Detailed re-engagement on the contract suite, Tramlines D/D on design etc through to close.

An alternative exists of freezing BBS's interest short of termination to sustain the perception of competition. This would almost certainly preclude successful litigation by tie and is not a particularly credible competitive backstop.

The implications are again not straight-forward :

- The timescale is likely to be around 6 months if matters progressed reasonably well. Programme will move out by this extent.
- There will be important changes to the current Infraco contract terms to accommodate 1) passage of time (eg programme, design & consents, MUDFA interface) ; 2) requirements of Tramlines (unknown)
- Introduction of entire Tramlines Proposal replacing BBS's version and need to align with design and ER's
- Uncertainty about Tramlines attitude to risk profile
- Loss of qualitative advantages perceived to be in BBS proposal which supported their selection as preferred bidder.
- Likely that tie would be required to meet bid costs
- No guarantee that Tramlines would adhere to previous deal and a strong likelihood that they will require increments for inflation and other factors ; impossible to estimate at this stage whether there would be adequate compensating factors (such as reduced SDS risk)
- Limited likelihood of imposing effective sanctions on Tramlines to adhere to existing terms – eg pay bid costs only if they stay within current contract terms especially price
- Probable need to re-assess SDS Novation Agreement (driven by SDS)
- Presumption that CAF will happily go along with this and not seek incremental costs

This option is more likely to lead to increased cost and programme delay than the Siemens-led approach. It is possible it could be deployed after an attempt were made to agree terms with a Siemens-led consortium. It is questionable whether CEC and TS would be supportive, although it is part of the existing procurement process and may be supported given the level of investment already made.

(C) Full re-procurement

This is the worst-case alternative short of termination. The procurement programme would extend out to around 1 year, adverse programme and cost ramifications are inevitable and it may be difficult to generate sufficient market interest from the limited number of possible players, including those rejected under the current procurement programme.

Notwithstanding the extent of public investment already made, it is highly questionable whether the public pound is best protected by embarking on an immediate full-scale re-procurement. CEC and TS's support for this approach is unlikely.

Recommendation

In addition to the primary considerations above, a range of secondary problems lurk, including :

- the sustainability of the design work
- the political threat arising from both loss of public confidence and the emergence of alternative uses of the funding
- implications of a delayed starting date on embargoed construction periods
- the continuing role and cost of Transdev
- need to revisit third party agreements
- ability to freeze work underway and avoid undue cost
- retention or re-shaping of tie resources

And many more.

Painful as it is, there seems little question that the route which will lead to the best value for money is to agree and complete the BBS deal as close to the current terms as possible.

GB
1.05.08